Venn Brown
Investment Research & Advisory

One to Watch

Credit Clear

Meeting with CEO Andrew Smith

21st September 2023

Venn Brown sat down with Andrew Smith, CEO of Credit Clear to discuss the current state of the business and where he wants to take it.

Thanks for meeting with us today Andrew. To start with, can you give us a brief overview of Credit Clear?

Credit Clear's purpose, across all its businesses and services, is to provide a better way to resolve bad debt and overdue account situations.

The first way we do this is through our software solutions. We provide digital solutions to help people pay their bills more efficiently, effectively, and with less friction.

It could be from the moment a bill becomes overdue or just before it becomes overdue, where you are prompting people through digital communication on their smart device that a bill is due and payable in two days. "Here's some easy ways to make a payment", or "here's some ways to set up an arrangement to pay in the future". It's around reducing the friction around the debt recovery process, both internally and externally.

This solution is sold either on a reoccurring fee-per-file model or using a software-as-a-service (SaaS) solution.

Can you tell us about your services business?

ARMA is the services component of Credit Clear. ARMA is a debt management and recovery outsourcing partner to organisations and credit providers. The ARMA business uses Credit Clear's technology to provide a digitally-led or digitally-enabled process to collect overdue accounts. This could be 30 days overdue, 60 days overdue, or 90 days overdue.

We use a hybrid of digital and traditional methods to solve that account in the best possible way, which we view as collecting the most amount of money in the shortest period of time with the least amount of friction on the customer [the debtor]. A key part of our business is to remain focused on empathy and ethical treatment of the vulnerability.

Credit Clear

ASX:CCR

Sector	Application Software
Date	21st September 2023
Share price	$0.200
52-week range	$0.175 / $0.510
Market cap	$82.5m
Free float	51%
Dividend	-
Yield	-

Year end 30 June	2020	2021	2022	2023
Revenue	$6.5m	$11.0m	$21.5m	$36.0m
EBITDA	-$3.9m	-$6.0m	-$9.7m	-$4.0m
EBIT	-$4.9m	-$7.6m	-$12.5m	-$8.1m
Net profit	-$4.3m	-$8.0m	-$11.1m	-$11.1m
Earnings per share	-$0.03	-$0.04	-$0.04	-$0.03
Operating cash flow	-$2.2m	-$4.0m	-$5.9m	-$2.8m
Free cash flow	-$2.2m	-$4.1m	-$6.2m	-$3.0m
Net debt	-$0.8m	-$9.6m	-$8.5m	-$6.9m
Net debt / EBITDA	-	-	-	-
Dividend per share	-	-	-	-
ROA	-30.9%	-35.9%	-16.1%	-6.7%
ROE	-48.3%	-49.1%	-29.0%	-18.2%

3-year Price Chart

Analysts

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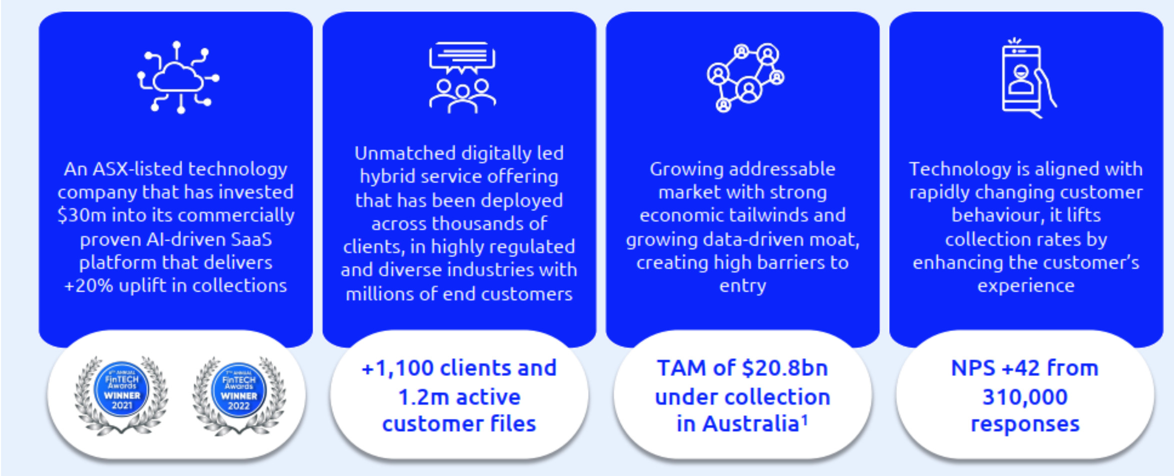
Figure 1: Technology driven debt collection resulting in +42 NPS score



Source: Credit Clear

And finally, where does Oakbridge Lawyers fit in with Credit Clear?

Oakbridge Lawyers is the third part of our business. Oakbridge Lawyers is a legal firm that exists to effectively service our clients when one of their customers owes a large amount of money, and we've been unable to solve it through any of our other methods.

An example could be a local council (we do a lot of work with councils). When someone owns a property and they have not paid their council rates for two years, then the council can take action through our legal firm to secure their interest in the account and go through a process of recovering money through the courts.

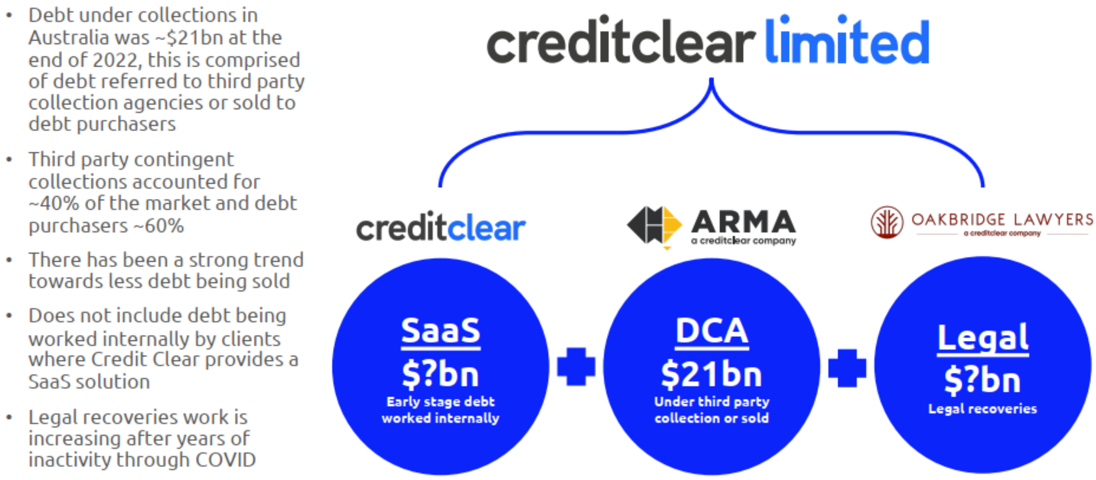
So looking at the three businesses: the first part is a technology-driven solution; the second is a hybrid around people and technology; and the third is really around the litigation processes.

That's what the coming together of Credit Clear and ARMA created[1]. ARMA is a really strong, disciplined, financially sound business that is growing fast, with deep industry relationships and a wonderful sales team. Credit Clear, with its brilliant data scientists, engineers and developers, has created an AI-powered process optimisation platform for our industry. The combined value of both businesses was far greater than the sum of the individual pieces, with each section leveraging the other's skills, expertise, capabilities and relationships.

What we've done is we've overlaid the two businesses with the view to driving up gross profit margin by converting expensive analogue processes to more efficient and scalable digital processes. Then upsell and cross-sell software solutions to existing customers that are using us as a third-party collection agency as well as exploring new opportunities within the market.

[1] Credit Clear bought traditional debt recovery business Australian Recoveries & Mercantile Agents (ARMA) in early 2022. ARMA was founded by Andrew Smith who was Managing Director before becoming Credit Clear CEO

Figure 2: Credit Clear benefits from the declining share of debt being sold



Source: Credit Clear

That all sounds very different to the baseball bat-wielding debt collectors that most people think of.

Yes, we are a baseball bat free company. But it is the most common comment I receive when people hear that I work in debt collection. I'm surprised there's still that perception that someone with a baseball bat would still exist in today's society. They would be lynched.

ASIC and the ACCC have stringent rules around debt collection. It includes things like the number and types of contact you can make and who you can speak to. For instance, you can't speak to someone's wife and tell them their husband's got a debt. You can't have more than three unsolicited contacts per week or 11 per month. That's how our AI-powered technology adds so much value. Clients are limited in how many actions they can take, so choosing the one with the highest chance of a positive outcome is increasingly important.

Credit Clear and ARMA were both driven by customer experience and empathy before the regulators brought in these restrictions, and it's one of the reasons we grew so quickly and why combining the businesses made sense. Now everyone has to be an ethical collector, but our point of difference continues to be our collection performance. Our point of difference isn't just we're an ethical collector, it's that we continue to provide great recovery rates. We achieve this through artificial intelligence and by contacting our client's customers in the way the customer prefers.

And just to be clear, Credit Clear doesn't buy debt, does it?

No, we don't buy debt. People confuse Credit Clear with other credit companies when in fact, we couldn't be any more different because most of the well-known credit companies are predominantly debt buyers. We never buy debt and have no intention of ever buying debt. We're there to serve our customers, help them collect money from their clients, and assist them from a cash flow point of view.

Can you talk us through your revenue model?

Our revenue is based purely on the amount of work we do and the resources we deploy. In the software as a service component (where we work under the name and branding of our client rather than under our own brand), it's usually a fixed licencing fee per file sent to us.

The third-party debt recovery services (where we work under ARMA's brand) are typically commission-driven. We charge a commission on success. This is still our primary source of revenue.

Some companies in banking and finance, including one of the big four banks, don't pay commissions anymore because they think it motivates the wrong behaviours. They'll rather pay you for a workflow of activity on a per file basis.

We also employ a business process outsourcing (BPO) type model as well. We'll have outsourced people on phones working on behalf of our clients and simply charge the client a fee per file based on what they send across. It's still predominantly in the third-party collection space.

Looking at the breakdown, probably 10% of revenue comes from the software as a service. 70% to 80% is from third-party digitally led collections, and then 10-20% is from legal work.

How has the competitive landscape changed?

The competitive landscape has shrunk dramatically. Collection House fell over. Milton Graham and the old Dun & Bradstreet recoveries business merged with Recoveries Corp. There are now meaningfully fewer choices for our clients to choose from, and we're seeing an increase in the value of accounts being referred to us.

Large organisations usually want more than one recovery agent, so the recent market consolidation puts us in a strong position to win future business. The merger of Milton Graham and Recoveries Corp opens opportunities for companies previously using both companies because they now need to find a new supplier.

Added to that, there's less debt being sold in the market because of the continued social responsibility that companies have when selling their debt to buyers; where from a governance and brand reputation perspective they are no longer offloading the responsibility for the ethical treatment of their customers.

COVID created a huge reduction in debt being sold. Westpac hasn't sold debt for four or five years. Telstra is selling a lot less. I heard some pretty interesting stats from the debt sale brokers. Previously there used to be around $350 to $400 million worth of debt sold each year, but now it's around $150 million. That's tough for the debt buyers, but it's great for us. Not only are there fewer competitors who provide outsourcing and debt management services, thereby increasing our market share, but now there is a much larger addressable market of companies who previously sold their debt, but now want help managing their debtors.

With all the headlines screaming "cost of living" and "mortgage cliff" and "rental crisis", what are you seeing in terms of defaults?

The figures vary between industries, but NAB's recent survey reported default rates had gone from 6% to 9% on credit cards. It's gone from 5% to 9% on insurance payments and from 8% to 12% on utility bills. Credit Clear is a beneficiary and we are perfectly placed to help companies because we manage the problem for our clients in an integrated end-to-end way, through software, people in call centres or our legal firm.. We offer clients a complete debt resolution solution with offerings that fit various parts of the market. Be it dealing with B2C [business to consumer] utilities where a customer has missed a bill or the top-end-of-town, high-dollar value accounts such as a builder-to-builder [default or delinquent payments] situation.

To summarise, not only are there fewer competitors, but we've also got some significant macro tailwinds helping grow the business.

What growth opportunities are there for each of your businesses?

Right now, our greatest opportunity to grow is in that third-party collection space; because of what I said about our competition and the market. Our clients' problems are expanding rapidly in the current environment, with default rates increasing 50% over the last 12 months.

Our digital product also provides us with a significant growth opportunity. It works perfectly across the high-volume consumer space, and we're now training and customising it to work in the insurance space. To give you an idea of some of the opportunities, purely from a margin perspective, our digital collections business in the consumer space operates on a 62% margin compared to the insurance space at 50%. As we roll out the digital solution within insurance, we should be able to lift the insurance margin to 62% so that extra 12 percentage points of margin falls straight to the bottom line.

Looking further out, if I put a circle around the top 20 customers we aim to work with in the future, we could grow the business by several multiples with those 20 customers alone.

What do you see as your competitive advantages?

We feel very strongly about our competitive advantage in terms of technology. We've also got a 100% Australian-based call centre, so the people speaking to those most vulnerable individuals are trained, licensed collection staff, unlike other call centres that don't necessarily deliver the same level of service.

Technology unpins our whole organisation now. Take an extreme example, but one that has happened; let's just say someone on the phone speaks to a person who's suicidal; there's a real-time control that listens to all the phone calls, and that gets flagged as an issue. It gets immediately kicked up to a manager, and we can get on the phone and send the police out to do a welfare check on the individual. That happens very, very rarely, but occurances of domestic violence and financial control are much more frequent.

It's a critical component of our service delivery that we manage the most vulnerable people really, really well. That's why we've got a great net promoter score of positive +42, which is better than most of our clients' own customer service centres. It's way better than the banks'[2] internal teams. The banks improved dramatically over COVID, which is great, but I think at least part of the reason we have such a great net promoter score is that people would like to use our type of software as soon as the debt becomes in arrears. If they get the opportunity to use our notification and payment software at 30 to 60 days, they go, "hold on, we'd rather have done this before we got 60 days overdue. I missed five or four phone calls

[2] Net promoter score (NPS) is a measure of how likely customers are to recommend a business to their friends and family. It ranges from -100 (highly unrecommended) to +100 (everyone recommends). A score of 0 is good, >50 is excellent and >80 is world class. The top Australian financial institutions typically have an NPS scores ranging from high 30s to low 40s. The big 4 banks are usually between 15-20. The least favoured banks have scores of -10 to -20.

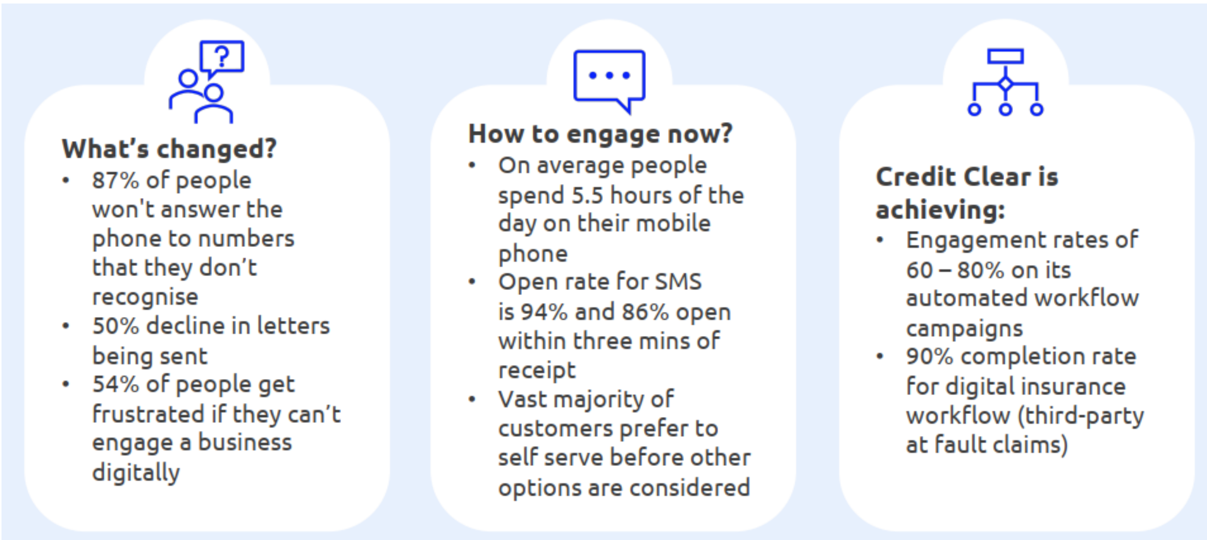
and two letters in the post because they were sent directly from the bank. Now I'm getting a digital message sent to me predictively at a time that I'm available to open it, and predictively with some messaging that's going to get the best outcome for me. I'll set up an arrangement that meets my financial position. Yes, I would recommend that to someone else." It's a little bit like reverse marketing.

The metrics on which we measure our business are around recovery rates, net promoter score, and customer satisfaction, and they're all tick-tick-tick.

We're also seeing real generational change. Millennials and Gen Z don't want to speak to someone on the phone. They don't want to have a phone call from an internal department at their bank. They don't want to have a phone call from us. They'd rather get a message sent to them on the phone that allows them to communicate their financial situation and an interim arrangement that allows them to manage and pay their debt in a timely manner.

Across the board, we have really strong performance. We have really strong controls around data protection. We've got a really strong reputation around collection rates. We've got a really strong reputation around net promoter score and how we treat the customer.

Figure 3: Credit Clear's AI technology customises communication methods to maximise engagement



* Market research by Swift Digital
Source: Credit Clear

Bringing that all together then, how competitive have you been in the market?

We've got a really defined process between doing early stage, middle stage, hybrid solutions and also late stage. We just won a services contract for a major financial institution where we came on as a challenger agency, outperforming three other collection agencies to get the majority of the work. The same thing happened with a major grocery wholesaler/distributor. Every single time we are tested against our competition, we consistently outperform our competition.

We've won six out of seven tenders this year. It's been an extraordinary year, including the large tenders I mentioned as well as a big four bank, a big telco, one of the largest utility companies in Queensland and the second-largest health technology business.

These are big clients. If I was to sign one of those every two years, I would have been happy and we've signed six out of seven in the last 12 months.

We're getting really good traction in banking and finance at the top end of town. We do a lot of work with utilities around the country with the big water, gas, and electricity. We're also building our government business. We work with TAFE New South Wales, and Revenue New South Wales is a big target for us. We've got active opportunities to work with federal, state, and local governments. We're on the local government procurement boards for five different procurement panels. We're an approved vendor for a lot of those states and territories. So overall, we're competitive in a lot of markets, and there are still many more markets that we are growing into.

That's an impressive win rate. How long does each contract last?

There's always risks and costs to moving to a new collections provider, so if you do a good job for a client, you'll work for them for 10-plus years. The contracts are typically three years with a two-year extension, which are then often rolled.

As I also mentioned, most large companies will have two or three agencies, but the best-performing agency will be given an increasing share of the work. And we've performed really well on these accounts. On several occasions, we've been brought in as the third provider and been given a small share of work, maybe 10-15%, but over time as our collection rates and times outperform, our share of the work has grown to 30% or 40%.

What is your client churn rate?

We're in a really good spot where our client retention has been great. We've lost none of our top 20 clients, which represent 80% of our revenue. We do still take on smaller customers that we can service profitably, but they might only have two or three debts a year, and they never need us for anything more than that.

But when talking about customers consistently giving us work every month, I can honestly think of no customers we've lost in the last 12 months.

In 2021 (before Credit Clear acquired ARMA), when the company was very different, we lost a major utility and BMW Financial Services as clients. As we've discussed, since then, the company has changed a lot, and we've completed the integration of several businesses that we bought over the last few years.

The upshot is that we recently won back BMW Financial Services and are in an excellent position to win back that major utility when it goes to tender in a few months.

What do you see Credit Clear looking like in three to five years time?

Look at our BHAG[3], which we've done a lot of work on from a strategy point of view with the Board, Senior Leadership Team and the wider management group, is that we want to build a business that is a dominant provider in the Australian debt resolution market. If we do this we'll be turning over in excess of $100 million dollars and generating a healthy EBIT to revenue ratio of 30%.

We definitely want to leverage the technology to deliver an improved gross profit margin while growing exponentially. We'll reinvest a lot of that EBIT back in terms of growth in the

[3] BHAG = Big, hairy, audacious goal

next three years, but we want to get to a point where, at any one point we can maintain the technology investment, maintain the sales investment, maintain the marketing investment to a point where we are a business that's turning over in excess of $100 million and generating around $30 million worth of EBIT.

Seeing that we're a listed business, how do we work back from that in terms of valuations? We are targeting growth of more than +20% a year from a combination of organic and acquisition lead growth. I think that we can get to $60 million plus in the next three years in terms of turnover organically and we'll need to look for the other $40 million in terms of acquisitions.

We're also open to other opportunities. Assuming the economics work, it's not our strategy yet, but if we're looking at bolt-ons [bolt on acquisitions], it could be a beachhead into a new international market. If we're going to go anywhere, it'd be the UK or the US.

With the UK, if there were a great little collection agency similar to ARMA to buy in the UK we'd jump on it. Basically, we'd repeat the same strategy Credit Clear used in buying ARMA in Australia, building out the technology and overlaying it with a great management team. We'd do the same thing in the UK.

These goals are definitely aspirational. It's a big audacious goal. That said, we're building our budgets and our targets based on growing this next year by +20% plus, which gets us to $41-42 million from $36 million.

Then if we can go another $20 million by year three, we'll be at $61 - $63 million of gross revenue. We've got the customers now that we're either working with or we've signed and I can really see a clear path of getting there organically. If we can do that and simultaneously look for bolt-ons and growth opportunities through inorganic growth, then getting to $100 million and an EBIT number based on our gross profit margin remaining at 55%, pushing towards 60% on every new dollar we bring in, it's very achievable.

What's the biggest risk that you face to those goals?

The biggest risk is that we grow too quickly and drop the ball for existing or new customers as they come on board. Ours is very much a business based on performance, and if you do a great job for your customers, you retain them forever. If you are a bad job, you can lose them.

We're in a really good spot where retaining customers has been great, but as you expand quickly and grow the business, it creates pressure on the delivery team to onboard and then make sure that we have the same standard of performance that we've always had on this business.

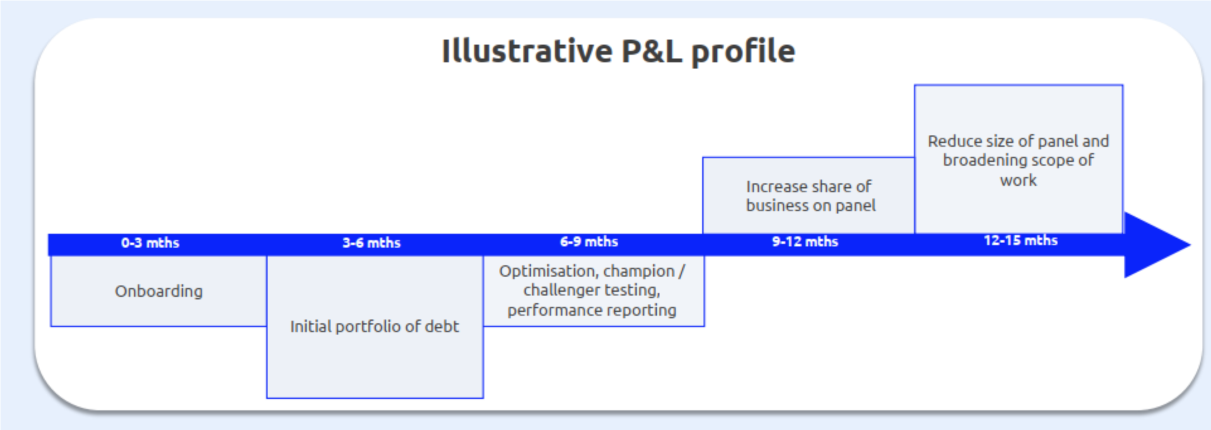
What do you think is the most misunderstood part of the business?

Aside from the confusion between us and others who buy debt, the next most pressing misunderstanding is the onboarding cycle and the lag between signing a new customer and generating cash flow.

Signing a contract with a customer is effectively the start of the relationship, but for the share market, it's like, "Perfect, how much revenue should we book for that new customer next month?" Like Queensland Urban Utilities, we signed that late last year. We didn't start billing them until May this year. They're a multi-million dollar-a-year client, but there's a seven-month lag between signing the deal and recognising revenue. But then it went from zero to

$300,000 in a single month. It'll probably normalising around $200,000 worth of billing a month. It's a $2.4 million customer, not a $1 million customer.

Figure 4: It can take 9-12mths to start generating revenue from a new client



Source: Credit Clear

We've done the same in the past where we've said that we've signed 20 odd customers or 30 customers in a month. That represents a future revenue opportunity of maybe a million dollars.

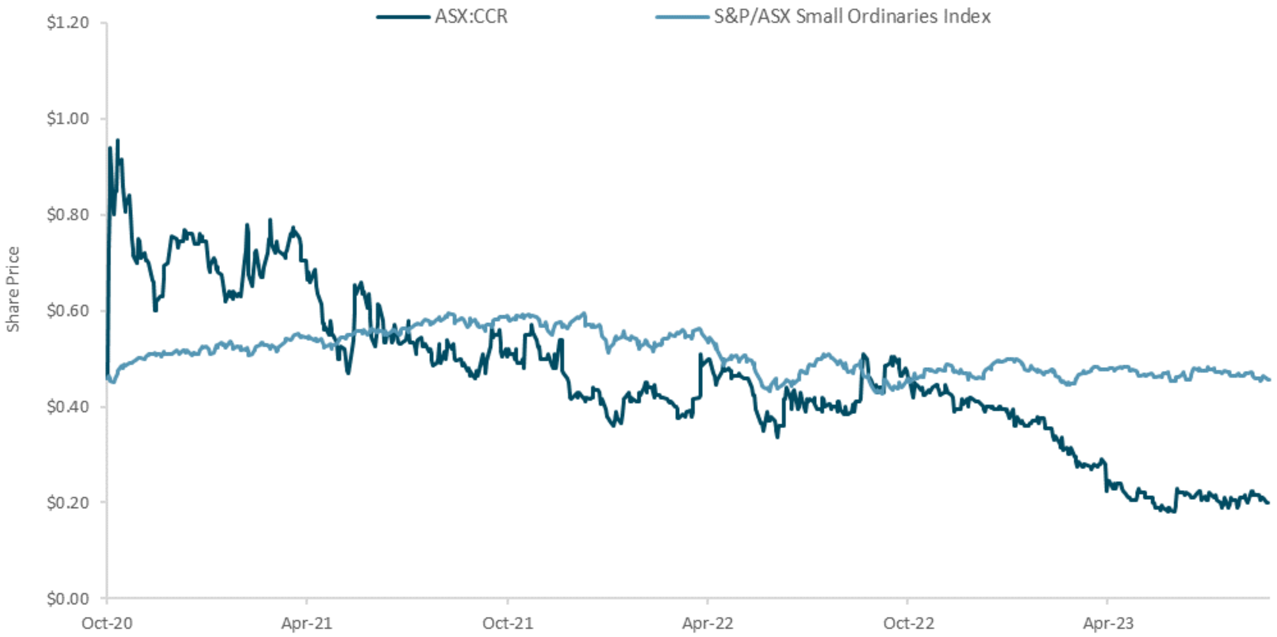
The market starts to add all those together and say, "Why isn't the business growing by $10 million this year? Because that's what you've announced as wins." I said, "Yes, but we've only had three months worth of billing for that one customer. We've had zero months worth of billing from the other customer." Out of those six tenders that we've won, there was only one customer of those tenders that we actually saw any revenue in last financial year's figures.

The time it takes between signing a customer, onboarding them, getting some work through the door, charging a commission on that work, and then getting more work, a greater proportion of that work through the door based on performance, and getting to a point where we're billing them $200,000 a month is a much longer process than the market understands or appreciates or respects. It's a slow process.

On the flip side, if you were to switch it off, there's a very slow switch-off as well. It's like a steam train. It's a long roll of speed up and then a long time of slowing down. The robustness of the nature of the business is that it's strong because of the momentum that it has. It takes a long time to build growth momentum, but once it's there, it just keeps going.

Even if we didn't sign another customer in the next 12 months, we could still get that +20% growth rate. Most of what's been budgeted as next year's growth is from new customers that we've not yet seen any dollars from.

Share price performance



Source: S&P Global

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